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Committee of Experts on International Cooperation in Tax Matters
Fifteenth session
Geneva, 17-20 October 2017

Provisional agenda and organization of work

Provisional agenda

1. Opening of the session by the representative of the Secretary-General.
2. Election of the Chair and Vice-Chairs of the Committee.
3. Remarks by the Chair of the Committee.
4. Adoption of the agenda and organization of work.
5. Discussion of substantive issues related to international cooperation in tax matters:
   - (a) Procedural issues for the Committee;
   - (b) Issues related to the updating of the United Nations Model Double Taxation Convention between Developed and Developing Countries:
     - (i) Base erosion and profit shifting: updates in relation to:
       - a. Articles 1 and 5, including:
         - i. The treatment of issues related to insurance and reinsurance issues;
         - ii. Other issues related to permanent establishments;
       - b. Article 13 (Capital gains): the application of paragraphs 4 and 5;
     - (ii) Article 12 (Royalties): possible amendments to the commentary on article 12 in relation to software-related payments;
   - (c) Other issues:
     - (i) Possible update of the United Nations Practical Manual on Transfer Pricing for Developing Countries;
     - (ii) Possible update of the Extractive Industries Handbook;

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(iii) Possible update of the Manual for the Negotiation of Bilateral Tax Treaties;

(iv) Treatment of collective investment vehicles;

(v) Mutual agreement procedure — dispute avoidance and resolution, including possible updates to the United Nations Model Double Taxation Convention and its commentaries and the guide on the mutual agreement procedure, as well as further work on the handbook on dispute resolution;

(vi) Hybrid entities;

(vii) Capacity-building;

(viii) Environmental tax issues of relevance to developing countries;

(ix) Tax consequences of the digitalized economy — issues of relevance for developing countries;

(x) Taxation of development projects;

(xi) Other matters for consideration.

6. Provisional agenda for the sixteenth session of the Committee.

7. Adoption of the report of the Committee on its fifteenth session.

Provisional organization of work

Date	*Item*	
Tuesday, 17 October		
9-10 a.m.		Registration of participants
10-11 a.m.	1	Opening of the session by the representative of the Secretary-General
	2	Election of the Chair and Vice-Chairs of the Committee (closed session)
	3	Remarks by the Chair of the Committee
	4	Adoption of the agenda and organization of work
11-11.15 a.m.		Coffee break
11.15 a.m.-12.15 p.m.	5 (a)	Procedural issues for the Committee
12.15-1 p.m.	5 (c) (ix)	Tax consequences of the digitalized economy — issues of relevance for developing countries
1-3 p.m.		Lunch break
3-4.45 p.m.	5 (c) (ix)	Tax consequences of the digitalized economy (*continued*)
4.45-5 p.m.		Coffee break
5-6 p.m.	5 (b) (ii)	Article 12 (Royalties): possible amendments to the commentary on article 12 in relation to software-related payments
Wednesday, 18 October		
10-11.45 a.m.	5 (c) (viii)	Environmental tax issues of relevance to developing countries
11.45 a.m.-12 p.m.		Coffee break
12-1 p.m.	5 (c) (i)	Possible Update of the United Nations Practical Manual on Transfer Pricing for Developing Countries
1-3 p.m.		Lunch break
3-3.30 p.m.	5 (c) (i)	Possible Update of the United Nations Practical Manual on Transfer Pricing for Developing Countries *(continued)*
3.30-3.45 p.m.		Coffee break
3.45-5.15 p.m.	5 (c) (ii)	Possible update of the Extractive Industries Handbook
5.15- 6 p.m.	5 (c) (x)	Taxation of development projects
Thursday, 19 October		
10-11.45 a.m.	5 (c) (iii)	Possible update of the Manual for the Negotiation of Bilateral Tax Treaties
11.45 a.m.-12 p.m.		Coffee break

Date	*Item*	
12-1.00 p.m.	5 (c) (iv)	Treatment of collective investment vehicles
1-3 p.m.		Lunch break
3-4.30 p.m.	5 (b) (i) a.	Base erosion and profit shifting: updates in relation to: Articles 1 and 5, including: i. The treatment of issues related to insurance and reinsurance issues ii. Other issues related to permanent establishments
4.30-4.45 p.m.		Coffee break
4.45-6 p.m.	5 (c) (v)	Mutual agreement procedure — dispute avoidance and resolution, including possible updates to the United Nations Model Double Taxation Convention and its commentaries and the guide on the mutual agreement procedure, as well as further work on the handbook on dispute resolution
Friday, 20 October		
10-11.30 a.m.	5 (b) (i) b.	Base erosion and profit shifting: updates in relation to: Article 13 (Capital gains): the application of paragraphs 4 and 5
11.30-12 p.m.		Coffee break
12-1 p.m.	5 (c) (vi)	Hybrid entities
1-3 p.m.		Lunch break
3-4 p.m.	5 (c) (vii)	Capacity-building
4-4.45 p.m.	5 (c) (xi)	Other matters for consideration
4.45-5 p.m.		Coffee break
5-5.45 p.m.	6	Provisional agenda for the sixteenth session of the Committee
5.45-6 p.m.	7	Adoption of the report of the Committee on its fifteenth session; closing of the session

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Committee of Experts on International Cooperation in Tax Matters
Fifteenth session
Geneva, 17-20 October 2017
Item 5 (c) (viii) of the provisional agenda*
Environmental tax issues of relevance to developing countries

Update on environmental taxation

Note by the Secretariat

I. Background

1. The Committee of Experts on International Cooperation in Tax Matters first considered the topic of environmental taxation in a comprehensive fashion at its twelfth session, in October 2016. On that occasion, Ingela Willfors of Sweden (as a member of the Committee of Experts) initiated the discussion of the item by pointing out that the base erosion and profit shifting project of the Organization for Economic Cooperation and Development (OECD) and the Group of 20 (G20) had signalled that the least developed countries, though most affected by environmental changes, were the least likely to apply environmental taxes because of the lack of capacity and resources and the dearth of knowledge in the application of indirect tax systems. She highlighted that Sweden had been applying carbon taxes for over 25 years and had set a possible example for other countries. Carbon tax had been the policy of choice for Sweden (over other forms of environmental taxation such as value added tax (VAT)-like taxes, energy consumption taxes, energy excise taxes and emissions trading mechanisms) owing to its administrative simplicity and low cost.

2. Susanne Åkerfeldt from the Ministry of Energy of Sweden then outlined the Swedish experience in greater detail. Ms. Åkerfeldt gave a presentation on the significance of environmental taxation for developing countries' economic development. Her presentation analysed how a country might design its tax system in order to raise revenues while making use of indirect taxes and other environmentally sound policies.

3. Ms. Åkerfeldt noted that one of the benefits of applying a carbon tax is that the cost is low. Carbon tax can be added to the existing fuel taxes without any additional administrative cost: the carbon tax is expressed as a trade unit, per weight or volume, similar to an excise tax; therefore countries already have the mechanisms

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in place to apply the tax. The country can also choose the point of taxation which is most beneficial to the tax administration, applying the tax where the taxpayers are less numerous (in Sweden, the tax is applied at the level of distributors and large consumers). Ms. Åkerfeldt gave a presentation on the Swedish experience at the thirteenth session of the Committee of Experts, in December 2016.[1]

4. Thornton Matheson of the International Monetary Fund secretariat gave a presentation at the twelfth session, emphasizing that both developed and developing countries may benefit from the application of a robust carbon policy.[2] Whereas developing countries have a more immediate need to raise revenues because they have a large informal sector and therefore have less of a basis upon which to apply direct taxes, developed countries can also benefit from the application of carbon taxes because their taxes tend to be largely distortive towards certain segments of the economy.

5. Ms. Matheson indicated the advantages of a carbon tax over other forms of energy pricing, emphasizing that carbon taxes are more economically efficient, have a more positive impact on the environment and are good revenue raisers. For developing countries, the fact that the tax is easy to administer represents a distinct advantage over other policies such as energy taxes and emissions trading schemes, which are more complex in administration. In that context, China was indicated as a relevant case study. At the thirteenth session of the Committee of Experts, Ms. Matheson contributed a presentation on environmental reform in developing countries, which focused on the need to remove fuel-related tax subsidies.[3]

6. Following the presentations at the thirteenth session, several business representatives expressed their support for a carbon tax over other forms of environmental taxation. Interest was also shown in specific features of the Swedish regime, while recognizing the need to respect developing country differences and realities.

7. At the fourteenth session of the Committee of Experts, held in April 2017, a further paper was presented,[4] which put environmental taxation in the context of the Paris Agreement[5] and other commitments made under the United Nations Framework Convention on Climate Change.[6] Ms. Willfors, with assistance from the Secretariat, provided a broad overview of the policy considerations to be explored by developed and developing countries should they wish to introduce environmental taxes.

8. In that paper, it was noted that many developing countries are confronted with low government revenue, for a variety of reasons. The OECD/G20 project has shed light on how harmful base erosion and profit shifting can be, particularly for developing countries lacking the resources to control and tax offshore transactions, even if the main economic activity took place or value was created in their territories. Tax avoidance strategies, as well as the failure to capture rent deriving from the activities taking place in a country's territory are issues which are inherent to direct tax systems, where the application of the tax will be dependent on the country's ability to attribute the income to an activity taking place in its territory.

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[1] The presentation can be found at www.un.org/esa/ffd/wp-content/uploads/2016/12/13STM_Presentation_Akerfeldt_5Dec16.pdf.

[2] See E/C.18/2016/CRP.6, available from www.un.org/esa/ffd/events/event/twelfth-session-tax.html.

[3] See www.un.org/esa/ffd/wp-content/uploads/2016/12/13STM_Presentation_Matheson_5Dec16.pdf.

[4] See E/C.18/2017/CRP.6, available from www.un.org/esa/ffd/wp-content/uploads/2017/03/14STM_CRP6_carbon-tax.pdf.

[5] See FCCC/CP/2015/10/Add.1, decision 1/CP.21, annex.

[6] United Nations, *Treaty Series*, vol. 1771, No. 30822.

Additionally, low oil, gas and commodity prices have created a downward pressure on income for resource-rich countries. In many developing countries a large portion of economic activity occurs in the informal sector, which hampers the raising of revenues from broad taxes on labour, capital and consumption. In contrast, revenues may be derived from the indirect taxation of fossil fuels used by the informal sector, that is to say, by taxing the fossil fuels prior to reaching the informal sector as a final consumer, thus capturing the rent associated with that oft-excluded economic sector.

9. Indirect taxes thus offer developing countries an opportunity to tax income upon consumption of a good or service, at the point which is most convenient for the tax administration to apply the tax. Because indirect taxes tend to lack the cross-country dimension, they can offer a less complex alternative by which developing countries accumulate substantial revenues without having to invest in the hiring of additional labour or the acquisition of new technological resources.

10. Environmental taxes can therefore be considered as a form of indirect taxation that would be easy to administer and would guarantee a steady revenue flow, while requiring little in terms of resources from tax administrations. In discussions of how developing countries can achieve sustainable (tax) revenue in view of all the challenges mentioned above, environmental taxes in general and carbon taxes in particular should not be overlooked as elements to add to the mix of taxation or to replace existing non-effective taxes.

II. The climate change framework

11. The 2015 Paris Agreement requires all parties to the United Nations Framework Convention on Climate Change to put forward their best efforts through nationally determined contributions to curb greenhouse gas emissions and to strengthen those efforts in the years ahead. Contrary to the Kyoto Protocol to the Convention,[7] which had a preference for carbon pricing mechanisms, more specifically for cap and trade systems, the Paris Agreement does not endorse one particular method for countries to address their excess greenhouse gas emissions. By extending the array of fiscal and financial tools available for countries to tackle climate change, the Paris Agreement shed new light on the less costly alternative resources available to countries when designing climate change policies. Following the introduction of the Paris Agreement, environmental and carbon taxes have become ever more relevant as an alternative to carbon pricing mechanisms, and an equally effective way for countries to meet their goals under the Paris Agreement.

12. The Paris Agreement shows that climate change is an international issue that is best dealt with through local actions coordinated under a global framework. Countries now have a unique opportunity to use the Paris Agreement to concede to a minimum tax on pollution in general or carbon in particular. Provided the tax is incident on a pollution-intensive substance, such as oil, gas, coal or coke, a new environmental tax can be both beneficial to the environment and an effective revenue raiser. If the tax is commensurate with the pollution potential of the item subject to tax, and provided the final price of the item is not distorted in any way, the tax will have the effect of attributing a higher price to the more polluting substances and a lower price to the less polluting. That would provide consumers with an incentive to purchase the cheapest and least polluting fuel item available. Over time, the tax can act to change consumer behaviour and habits.[8]

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[7] FCCC/CP/1997/7/Add.1, decision 1/CP.3, annex.

[8] Tatiana Falcão, "BEPS and the Paris Agreement — unthinkable bonds", *Intertax Law Journal* (publication forthcoming, September 2017).

III. Country practice

13. The present section outlines country practice in the use of carbon taxes throughout the world. As is evident from the table below, most of the countries engaged in environmental taxation in general, and carbon taxation in particular, belong to the developed world. The table aims to highlight some of the features of existing and proposed regimes and, in doing so, to provide elements for discussion of the appropriateness of developing further guidance for countries wishing to address negative externalities through the use of environmental taxes.

Past, present and prospective environmental tax policy in selected countries[a]

Entity	*Tax*	*Items subject to tax*	*Taxpayer*	*Tax incentives*	*Point of application*	*Other taxes and instruments*
Australia[b]	Carbon price mechanism[c]	Carbon dioxide, methane, nitrous oxide and perfluorocarbon emissions	Facilities having direct greenhouse gas emissions of 25,000 tons or more of CO_2 equivalent emissions a year	Revenue recycling,[d] transitional assistance to coal-fired electricity-generating plants, free permit distribution	Downstream	–
British Columbia, Canada[e]	Carbon tax	Fuels and combustibles combusted in British Columbia territory (gasoline, ethanol, light fuel oil, biodiesel and others)	Purchaser of the fuel or combustible (distributor, vendor or collector)	Exported and non-combusted fuels are exempted from the tax; revenue recycling[f]	Downstream	Interested in joining cap and trade scheme together with the Western Climate Initiative; motor fuel tax
European Union (1991 hybrid proposal)[g]	Combined carbon and energy tax	Coal, lignite, peat and their derivatives, mineral oils, natural gas, ethyl and methyl alcohol and electricity	Person manufacturing, distilling, importing or processing the items subject to tax	Energy-intensive industries exempted; exported fuels and electricity exempted; revenue recycling at member State level	Downstream	–
European Union (energy directive)[h]	Energy tax	Minimum rates of taxation for energy products including electricity, natural gas, coal, oil; products such as motor fuel, motor fuel for industrial or commercial use, heating fuel and others[i]	Non-energy-intensive entities and entities or persons applying those oil and energy inputs for non-business purposes	1. The following are exempt from tax: (a) energy products and electricity used to produce electricity and electricity used to maintain the ability to produce electricity; (b) energy products supplied for use as fuel for the purpose of air navigation other than in private pleasure-flying;[j] and (c) energy products supplied for use as fuel for the purposes of navigation within European Union waters[k] 2. European Union countries may apply total or partial exemptions or reductions in the level of taxation to, inter alia: (a) energy products used in pilot projects for the development of more	Downstream	Applied in combination with the European Union emissions trading scheme, which is applicable to energy-intensive industries

Entity	*Tax*	*Items subject to tax*	*Taxpayer*	*Tax incentives*	*Point of application*	*Other taxes and instruments*
				environmentally friendly products; (b) biofuels; (c) solar, wind, tidal, geothermal, biomass or waste energy sources; (d) energy products and electricity used in rail, metro, tram and trolley bus services; (e) energy products supplied for use as fuel for navigation on inland waterways; and (f) natural gas and liquefied petroleum gas used as propellants 3. The directive provides measures to alleviate the tax burden on energy intensive businesses and/or businesses that undertake to achieve environmental protection objectives or improvements in energy efficiency 4. European Union countries may refund, fully or in part, taxes paid by businesses that have invested in the rationalization of their energy use. This refund may be as much as 100 per cent in the case of energy-intensive businesses and up to 50 per cent for other businesses		
United Kingdom (climate change levy and carbon price floor)[l]	Climate change levy: energy tax; carbon price floor: carbon tax	The carbon price floor[m] acts in addition to the climate change levy. Both taxes are levied on electricity, gas supplied by a gas utility company, petroleum gas, coal, lignite, coke and semi-coke (of coal or lignite) and petroleum coke[n]	The supplier/retailer	Energy-intensive industries exposed to international competition are able to apply for a climate change agreement. Provided they agree to certain targets, they would benefit from reductions of up to 80 per cent	Downstream	Hydrocarbon duty; climate change levy; European Union emissions trading scheme

Entity	*Tax*	*Items subject to tax*	*Taxpayer*	*Tax incentives*	*Point of application*	*Other taxes and instruments*
Denmark[o]	Energy and carbon dioxide tax	Fossil fuels and electricity.	All VAT registered enterprises making use of energy products that are not covered by the European Union emissions trading scheme	Biofuels are excluded from the tax	Downstream	Energy tax; sulphur dioxide tax; European Union emissions trading scheme
Finland[p]	Carbon dioxide tax	Any fuel applied for transport or heating purposes (including, but not limited to, petrol, diesel oil, light and heavy fuel oil, kerosene, aviation petrol, coal, natural gas and bio-substitutes of all the aforementioned fuels)	Retailers	Biofuels may benefit from a reduced rate of 50 to 100 per cent provided certain conditions are met; fuels destined to produce electricity are exempted; peat is subject to a lower rate; natural gas is subject to a tax expenditure; electricity used by industry benefits from a reduced tax rate	Downstream	Energy tax, additional stockpile fee and European Union emissions trading scheme
Norway[q]	Carbon tax	Petrol, auto diesel, natural gas, mineral oil and emissions deriving from offshore petroleum activities	Extracting companies	An exemption applies for energy-intensive industries; tax exemption for the processing industry; biofuels entitled to reduced tax rate; energy-intensive industries, industrial sectors and rail transport participating in an energy efficiency program are entitled to reduced tax rates	Upstream	Sulphur dioxide tax; nitrate tax; energy tax; European Union emissions trading scheme
Sweden[r]	Carbon dioxide tax	Fossil fuels used as motor or heating fuels	Individuals, households and small and medium-sized enterprises	Exemption granted to energy-intensive industries	Downstream	Sulphur tax; energy tax; vehicle tax and European Union emissions trading scheme

Entity	*Tax*	*Items subject to tax*	*Taxpayer*	*Tax incentives*	*Point of application*	*Other taxes and instruments*
South Africa (still under discussion)[3]	Carbon tax	Not yet determined (possibly fuels)	Not yet determined	First 60 per cent of emissions would be exempted from the carbon tax for all industrial segments; 10 per cent relief to be granted to certain sectors to account for technical and structural limitations (process emissions); 10 per cent relief to be granted to energy intensive industries; rebates for entities promoting carbon capture and storage; Feed-in tariffs to promote clean and renewable energy resources	Upstream and midstream	Not yet determined
Japan[7]	Carbon tax	Crude oil and petroleum products, gaseous hydrocarbons and coal	Retailer	Exemptions and reductions are granted, although a detailed description of those tax benefits was not discoverable	Downstream	Other excises on fuel

(Footnotes on following page)

(Footnotes to table)

[a] The survey on which this table is based was conducted in 2013. The cut-off date for potential amendments in the surveyed countries' legislation was July 2013. The full survey is published in Tatiana Falcão, "A proposition for a multilateral carbon tax treaty," doctoral dissertation, Vienna University of Business and Economics, 2016 (IBFD publication, forthcoming) (see http://permalink.obvsg.at/wuw/AC13710313).

[b] Clean Energy Act 2011, No. 131, 18 November 2011, as amended, including amendments up to Act No. 103, 2013, part 1, sects. 3 (a) to (d), p. 4. This legislation was later repealed. The repealing legislation is available from www.legislation.gov.au/Details/C2014A00083. See also R. Lyster, "Repealing the 'carbon tax': hidden costs and unanswered questions", Sydney Law School, available from www.sydney.edu.au/news/law/436.html?newsstoryid=12498.

[c] Started as a fixed price mechanism and then progressed into a flexible, open-market trading system.

[d] Used to protect emissions-intensive, trade-exposed activities through cash refunds to the industry. Revenue resources also used to assist households through income tax cuts, family payments and support for jobs.

[e] Carbon Tax Act, SBC 2008, 29 May 2008, at chapter 40, part 3, section 8 (on imposition of the tax on fuels) and section 12 (on imposition of the tax on combustibles).

[f] Revenue recycling is to occur through tax reduction of other taxes. The program is revenue neutral.

[g] Commission of the European Communities, "A Community strategy to limit carbon dioxide emissions and to improve energy efficiency", SEC(91) 1744 final (14 October 1991). The proposed carbon/energy tax was never enforced. The proposal was archived and a less economically burdensome approach was adopted in its place.

[h] Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity, L 283/51 (31 October 2003), available from http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:283:0051:0070:EN:PDF.

[i] Energy products and electricity are only taxed when they are used as motor or heating fuel, and not when they are used as raw materials or for the purposes of chemical reduction or in electrolytic and metallurgical processes.

[j] However, European Union countries may, for reasons of environmental policy, subject these products to taxation.

[k] European Union countries may limit the scope of the last two exemptions to international and intra-European Union transport. Therefore, for all air or sea transport within a European Union country or between two European Union countries that have signed a bilateral agreement to this effect, the countries may apply a level of taxation lower than the minimum set by the directive.

[l] With respect to the climate change levy, see Her Majesty's Revenue and Customs, Finance Act 2000, chap. 17 (2000), sects. 4(1) and 33(2). For information on the carbon price floor, see Her Majesty's Revenue and Customs, *Carbon Price Floor: Support and Certainty For Low-Carbon Investment* (London, December 2010). For general policy guidance, L. Marshall, *Economic Instruments and Business Use of Energy — A Report by Lord Marshall* (London, Her Majesty's Revenue and Customs, November 1998).

[m] The carbon price floor taxes the average carbon content of commodities.

[n] The climate change levy is only levied on supplies meant for industrial or commercial use.

[o] International Energy Agency, *Energy Prices and Taxes Quarterly Statistics — First Quarter 2013* (Paris, 2013). See also Danish Government, *Energy Strategy 2050 — From Coal, Oil and Gas to Green Energy*, No. 2011:7 (February 2011).

[p] Ministry of Finance of Finland, *Environmentally Related Taxes and Charges in Finland* (January 2012).

[q] Ministry of Finance of Norway, *Green Taxes 2011* (January 2011). See also Ministry of Finance of Norway, *The History of Green Taxes in Norway* (March 2007).

[r] Ministry of the Environment of Sweden, *Environmental Sweden in Brief — Economic Instruments* (8 October 2014), available from http://wayback.archive.org/web/20141111160533/http://www.government.se/sb/d/5400/a/43594. See also S. Åkerfeldt and H. Hammar, *CO_2 Taxation in Sweden: 20 Years of Experience and Looking Ahead* (June 2010).

[s] South Africa has not introduced specific carbon tax legislation yet. For background on the legislative proposal, see National Treasury of the Republic of South Africa, *Reducing Greenhouse Gas Emissions: The Carbon Tax Option*, discussion paper for public comment (December 2010) and Government of the Republic of South Africa, *National Climate Change Response — White Paper* (October 2011).

[t] Government of Japan, Ministry of Environment, *Details on the Carbon Tax* (2012), available from http://www.env.go.jp/en/policy/tax/env-tax/20121001a_det.pdf.

14. As demonstrated by the table above, most of the countries currently applying environmental taxes are members of the European Union. The Nordic countries are particularly active in this area and have had long experience with carbon taxes. Countries will diverge as to whether they apply the tax on an upstream,[9] midstream[10] or downstream[11] basis, and the effects of applying the tax at each of these stages should be further analysed by the Committee.

15. Most of the countries that have successfully introduced long-standing carbon taxes have started with lower tax rates and increased them over time. Many of the existing regimes grant exemptions to small and medium-sized enterprises. As demonstrated above, it seems clear that regional emissions trading schemes are compatible with environmental taxes.

16. Should the Committee of Experts consider it appropriate to develop guidance in the area of environmental taxation, it may wish to analyse how the results of that work would interact with the newly released handbook on taxation of extractive industries, perhaps leading to the introduction of a chapter in the next version of the handbook specifying where in the oil, gas and coal production chains a carbon tax might be applied.

17. A further issue is whether there would be areas of synergy between this work and the work of the World Trade Organization on trade and environment.

IV. Conclusion

18. Environmental tax issues have been considered and included in the agenda of the Committee of Experts on International Cooperation in Tax Matters for the last three sessions, and members of the Committee have historically been supportive of engaging in further work in this area. This is a forward-looking and important area of international tax law that has been positively influenced by adherence to the Paris Agreement by a record number of countries.

19. The survey has demonstrated that many countries are already benefiting from the administration of effective environmental policies, collecting the rent attributed to the tax and meeting the environmental targets set internationally by environmental agreements.

20. The subject is ripe for analysis by the current membership of the Committee, to determine how developed, developing and least developed countries' tax systems might benefit from the administration of effective environmental tax policies, drawing upon the work of others in this area and working with them as appropriate. This could be of great benefit to all stakeholders in tax systems.

[9] Upstream activities comprise, for example, the exploration and exploitation of fossil fuels for resource-rich countries, or the importation of fossil fuels for countries that do not hold mineral reserves.

[10] Midstream activities include, for example, the refining and transport of fossil fuels.

[11] The downstream phase comprises all activities related to the sale of the refined by-product to a final consumer.

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Item 5 (c) (ix) of the provisional agenda*
Tax consequences of the digitalized economy — issues of relevance for developing countries

The digitalized economy: selected issues of potential relevance to developing countries

Note by the Secretariat

I. Introduction

1. The present note aims to summarize some of the unilateral measures taken by countries around the world, since the beginning of the Organization for Economic Cooperation and Development (OECD) base erosion and profit shifting project, in an attempt to adapt their domestic tax systems to the new cross-border business models which use cutting-edge technology to circumvent the need to establish a taxable presence in the country where profits arise or where a consumer market is located.

2. The term "unilateral action" refers to any one-sided attempt to capture "rents" deriving from a digital activity (i.e. through the application of direct and indirect taxes) without engaging in the renegotiation of a bilateral tax treaty or consulting with other countries. It is characterized by the adoption of new tax laws or the reinterpretation of existing domestic laws or treaty provisions to adapt to an increasingly digitalized and globalized way of doing business. It is a bottom-up approach initiated by countries, as opposed to the top-down approach of OECD, which in its 2015 report on the digital economy announced its decision to continue work on the topic and produce a final report in 2020.[1] Some involved in the OECD digital economy work prefer the term "digitalized" to "digital" in this context, reflecting the view that there is no distinct digital economy, but rather the global

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[1] OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report* (Paris, October 2015), p. 138, para. 361. Available from http://dx.doi.org/10.1787/9789264241046-en.

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economy as a whole has been digitalized.[2] The use of the term "digital economy" in the present note should not be seen as a rejection of that proposition.

3. Interestingly, developed countries were the first to initiate legislation-based reform that would allow for the admission of unilateral actions to address the challenges of the digital economy. However, over time, some developing countries have picked up on that trend and have issued similar legislation.

4. The unilateral actions described in section II below are those of Australia, China, France, India, Israel, Italy and the United Kingdom of Great Britain and Northern Ireland. They can be divided into: (a) value added tax (VAT)-based measures, based on the geographical location of the consumer market; (b) presumed allocation of profits to a domestic jurisdiction (either by making use of a presumed permanent establishment approach as in the United Kingdom and Australian examples, or by requiring taxpayers to register in the country as a result of their digital presence); (c) taxes on the use of the country's digital infrastructure (as in India's equalization levy); and (d) transfer pricing-related measures (where transfer pricing rules are reformed to take into account the location of the consumer market, as in the Italian example). A further form of unilateral measure might be the application of border taxes to account for the digital activity, as in the recent tax reform proposal in the United States of America, although that is not referenced in any of the examples below.

5. Developing countries have the most to gain from the introduction of policies aiming to address the digital economy. For one, unilateral actions driven by the digital economy have greater emphasis on withholding-based structures, be they based on VAT, goods and services tax, income or profit, allowing countries to increase their revenue collection abilities through the mere "ownership" of a consumer market or a digital infrastructure. That is particularly interesting for countries with large consumer markets or countries facing a lag in development, because it attributes to the source country the right to tax without the need for physical presence.

6. A further argument is that this new way of doing business might lead countries to want to reinterpret or add on to the existing concept of permanent establishment (perhaps through the creation of a "digital permanent establishment", following the example of article 12A, referring to fees for technical services, in the new version of the United Nations Model Double Taxation Convention between Developed and Developing Countries). This would require revision of the United Nations Model Convention, and is a question that developing countries may want to debate under the aegis of the United Nations, even if also discussed in other forums. The Committee of Experts on International Cooperation in Tax Matters is still widely regarded as the only body in the world where developed and developing countries have equal standing in the development of tax policy norms. The Committee of Experts would therefore provide an environment in which developing countries, and least developed countries in particular, could enjoy equal standing in analysing issues related to the regulation of unilateral actions in view of the demands of the digital economy and the rerationalization of the concept of permanent establishment in the light of the unilateral developments. Developing rules that are fit for purpose for all nations is to the benefit of all stakeholders in tax systems.

[2] See, for example, https://ion.icaew.com/taxfaculty/b/weblog/posts/oecdbepswebcastanupdateon progress?Redirected=true. The BEPS Monitoring Group addressed the difference between the use of the terms "digital" and "digitalized" in its response to the 2014 OECD public discussion draft of *Addressing the Tax Challenges of the Digital Economy, Action 1* (see https://bepsmonitoring group.wordpress.com/2014/04/, commenting on www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf).

7. This topic is timely, and should be discussed now in the light of the unilateral measures introduced by countries across the world. These measures are only made possible by the lack of a common framework to regulate the distribution and allocation of taxing rights between countries. The result is to the benefit of some, but to the detriment of most, in particular those who are most fragile and least developed.

8. The present note does not provide an exhaustive list of examples; it merely aims to reflect the practices adopted by some countries, for purposes of illustration. Further work on the subject may be required if, for example, the Committee decides to create a subcommittee on the digital economy.

II. Country examples

Australia

9. Australia introduced the tax integrity multinational anti-avoidance law, which took effect on 1 January 2016.[3] Although the legislation was not specifically directed to the digital market, the reform is said to have targeted multinational companies generating sales in the country by running local initiatives but remotely concluding contracts with customers.[4]

China

10. China has been implementing reforms on both the corporate income tax level and the VAT level. The Ministry of Finance, the State Administration of Taxation and the General Administration of Customs jointly issued a notice on 24 March 2016 concerning the tax policy on cross-border retail e-commerce. According to the notice, the import of retail goods through e-commerce (i.e. business-to-consumer) is subject to customs duty, VAT and consumption tax. The price of the transaction, including the price of the goods, freight charges and insurance premiums, forms the tax base. The e-commerce enterprise, platform or logistics enterprise can act as a withholding tax agent.[5]

France

11. According to a French proposal,[6] a permanent establishment is deemed to exist when Internet user data are collected in a domestic market.

India

12. India's 2016 finance bill introduced an equalization levy.[7] The tax includes a surtax of 6 per cent levied on payments to foreign companies for online advertising services when those companies do not hold a permanent establishment in India. The Indian resident taxpayer has the obligation to withhold the tax upon remittance of

[3] Tax Laws Amendment (Tax Integrity Multinational Anti-avoidance Law) Bill 2015, The Parliament of the Commonwealth of Australia, 2015.

[4] EY, *Global Digital Tax Developments Review*, April 2016, available from www.ey.com/Publication/vwLUAssets/ey-global-digital-tax-developments-review/$FILE/ey-global-digital-tax-developments-review.pdf.

[5] IBFD, "Tax policy on cross-border retail e-commerce clarified", 31 March 2016.

[6] O. Popa, "Taxation of the digital economy in selected countries — early echoes of BEPS and EU initiatives", *European Taxation*, vol. 55, No. 1 (2016).

[7] Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, Government of India, "Proposal for equalization levy on specified transactions", report of the Committee on Taxation of E-Commerce (February 2016). Available from www.incometaxindia.gov.in/news/report-of-committee-on-taxation-of-e-commerce-feb-2016.pdf.

the payment abroad.[8] The equalization levy was the response of the Government of India to the OECD report of October 2015 on the tax challenges of the digital economy[9] and follows one of the reform options that OECD had discussed but not recommended in that report.[10]

Israel

13. In April 2016, Israel issued a circular regarding the taxation of foreign companies providing services in Israel through the Internet.[11] The circular emphasizes that income of foreign digital providers of services and goods to Israeli residents should be taxed even if they have no physical presence in Israel under the "conventional rules" (referring to the OECD report of October 2015[9] on the tax challenges of the digital economy).[12] An amendment to the VAT legislation was also under discussion according to the circular.

Italy

14. Italy is discussing a proposal to modify its transfer pricing legislation and to apply a withholding tax on intermediates, also referred to as a "web tax". The goal of the proposed legislation is to stipulate the use of valuation techniques other than cost-based indicators for determining the arm's-length prices of digital transactions.[13] The web tax, if accepted, will impose withholding taxes at source and modify the permanent establishment status by introducing a minimum threshold of revenues and costs test for multinational enterprises with a presence in Italy.[14]

United Kingdom

15. The Financial Act of 2015[15] enacted the diverted profits tax in United Kingdom legislation. The regulation provides that all profits found to be "diverted" will be taxed at 25 per cent. Profits are deemed to be "diverted" where a non-United Kingdom company seeks to avoid trading through a United Kingdom permanent establishment and where a United Kingdom company enters into an intragroup transaction lacking "economic substance" which results in an effective tax mismatch.

III. Conclusion

16. As well put by Michael Devereux, the proliferation of a variety of uncoordinated measures implemented within the existing framework is unlikely to provide a long-term satisfactory solution to the challenges to the tax system

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[8] Marcel Olbert and Christoph Spengel, "International taxation in the digital economy: challenge accepted?", *World Tax Journal*, vol. 9, No. 1 (2017), pp. 3-46. Available from www.ibfd.org/sites/ibfd.org/files/content/img/product/april_ppv_wtj_2017_01_int_4_international_taxation.pdf.

[9] http://dx.doi.org/10.1787/9789264241046-en.

[10] Manoj Kumar Singh, "Taxation of digital economy: an Indian perspective", *Intertax*, vol. 45, No.6 (2017), pp. 467-481.

[11] Circular 4/2016 (available in Hebrew only).

[12] IBFD, "Taxation of foreign digital companies — circular issued", 12 April 2016. Available from http://taxinsights.ey.com/archive/archive-news/israel--taxation-of-foreign-digital-companies---circular-issued.aspx.

[13] G. Gallo, "Italy — budget law for 2014 — details" (News IBFD, 7 January 2014).

[14] Marco Allena, The Web Tax and Taxation of the Sharing Economy: Challenges for Italy, *European Taxation*, vol. 57, No. 7 (2017).

[15] The Financial Act 2015, United Kingdom, chap. 11, part 3.

presented by digitalization.[16] For this reason, it is important to have an open debate regarding the options available for countries to deal with taxation of the digital economy in a treaty context, using a pre-defined framework that would increase governments' tax collection abilities while also being beneficial for business and the taxpayer.

[16] Michael Devereux and John Vella, "Implications of digitalization for international corporate tax reform" (to be published).

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Discussion of substantive issues related to international cooperation in tax matters

Update on selected current and expected publications of the Committee of Experts

Note by the Secretariat

1. The Committee of Experts on International Cooperation in Tax Matters is a subsidiary body of the Economic and Social Council responsible for keeping under review and updating proposals in relation to international taxation. The previous membership of the Committee made substantial progress in the area of international taxation by successfully launching, developing and/or updating five products in diverse and forward-looking areas of international taxation that are of particular interest to developing and least developed countries. The following new products have been developed or proposed since the end of the previous membership's term, in June 2017:

(a) An updated version of the United Nations Model Double Taxation Convention between Developed and Developing Countries;

(b) An updated version of the United Nations Practical Manual on Transfer Pricing for Developing Countries;

(c) A new United Nations Handbook on Selected Issues in the Taxation of the Extractive Industries for Developing Countries;

(d) The proposed outline of a new United Nations Handbook on Dispute Avoidance and Resolution, to be accompanied by the Guide to the Mutual Agreement Procedure;

(e) A newly revised version of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.

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United Nations Model Double Taxation Convention between Developed and Developing Countries

2. One of the highlights of the fourth version of the United Nations Model Convention is the introduction of a new article 12.A on fees for technical services, unique to the United Nations model, which increases the prominence of source-based taxation in the United Nations model, an issue that is of relevance to developing countries. The new version also incorporates some of the language of the base erosion and profit shifting project of the Organization for Economic Cooperation and Development.

3. In the 2017 update the Committee of Experts made several changes to the United Nations Model Convention to prevent taxpayers from using the provisions of bilateral tax conventions improperly to obtain treaty benefits. First, the title of the convention has been amended to refer expressly to "the prevention of tax avoidance and evasion". Second, a new preamble has been added which clarifies that tax conventions are not intended to create opportunities for tax avoidance or evasion, including tax avoidance through treaty-shopping arrangements. Third, a new general anti-abuse rule has been included in article 29, paragraph 9 of the United Nations Model Convention. This general anti-abuse rule and the specific anti-abuse rules included in tax treaties are intended to prevent transactions and arrangements from obtaining treaty benefits in circumstances where granting such benefits would be contrary to the object and purpose of the convention. These additions to the United Nations Model Convention will make the provisions of the convention more effective in preventing treaty abuse.

4. Other changes to the United Nations model include:

(a) A new version of article 1 that includes a fiscally transparent entity clause and a savings clause;

(b) A revised article 4 which includes a new tie-breaker rule for determining the treaty residence of dual-resident persons other than individuals;

(c) A modified article 5 that has the goal of preventing the avoidance of permanent establishment status;

(d) A revised article 10;

(e) A new version of article 13, paragraph 4 and a consequential change in paragraph 5;

(f) Some changes to articles 23A and 23B;

(g) A new article 29, which brings to the United Nations model a new limitation on benefits clause, alternatively to the application of a principal purpose test.

5. The new version of the United Nations Model Convention is expected to be published in October 2017, on the occasion of the fifteenth session of the Committee of Experts.

United Nations Practical Manual on Transfer Pricing for Developing Countries

6. The second edition of the United Nations Practical Manual on Transfer Pricing for Developing Countries was intended to be even more practical than the first edition and to provide greater country practice in the field of transfer pricing. Special attention was paid to the experience of developing countries and the capacity development work being done in this area. The goal was for the manual to

be more responsive to current country concerns and to reflect the rapid developments in this area.

7. The changes to the second edition of the manual include a revised format and the rearrangement of some parts of the manual for clarity and ease of understanding, including reorganization into four parts, as follows:

(a) Part A relates to transfer pricing in a global environment;

(b) Part B contains guidance on design principles and policy considerations, including substantive guidance on the arm's-length principle, with chapter B.1 providing an overview, chapters B.2 to B.7 discussing the key topics in detail and chapter B.8 demonstrating how some countries have established a legal framework to apply these principles;

(c) Part C addresses practical implementation of a transfer pricing regime in developing countries;

(d) Part D contains country practices, similarly to chapter 10 of the previous edition of the manual. A new statement of Mexican country practices is included and other statements are updated;

(e) There are new chapters on intra-group services, cost contribution arrangements and the treatment of intangibles;

(f) There is significant updating of other chapters;

(g) An index has been added to make the contents more easily accessible.

8. The Manual was digitally launched in April 2017 during the special meeting of the Economic and Social Council on international cooperation in tax matters, which followed the fourteenth session of the Committee of Experts. A paperback version is expected to follow in October 2017, on the occasion of the fifteenth session of the Committee of Experts.

United Nations Handbook on Selected Issues in the Taxation of the Extractive Industries for Developing Countries

9. A new handbook on taxation of extractive industries for developing countries has been completed and is ready to be launched. It is the first ever in this field, highlighting some of the issues developing countries should bear in mind when negotiating new contracts for the exploration and exploitation of natural and mineral resources within their territories. The handbook covers the following topics:

(a) Overview of extractive industries taxation issues;

(b) Fiscal take;

(c) Permanent establishment issues for the extractive industries;

(d) Indirect transfer of assets;

(e) Tax aspects of negotiation and renegotiation of contracts;

(f) Transfer pricing issues in the extractive industries;

(g) Value added tax in the extractive industries;

(h) Tax treatment of decommissioning for the extractive industries.

10. The objective of the handbook is to focus on specific areas of interest for developing countries. The handbook is expected to be published in October 2017, on occasion of the fifteenth session of the Committee of Experts.

Handbook on Dispute Avoidance and Resolution and Guide to the Mutual Agreement Procedure

11. The Handbook on Dispute Avoidance and Resolution and the Guide to the Mutual Agreement Procedure are tandem products which have been agreed upon but not completed by the previous membership of the Committee of Experts. Many of the features of the handbook and the guide are still to be determined by the current membership. An extended outline of the handbook has been made available for review and approval by the Committee of Experts at its fifteenth session.

12. The proposed handbook is to function as a living document, which would be regularly updated as developing countries gain more experience with the different dispute avoidance and resolution mechanisms. It could also provide practical guidance and instructive case studies drawn from real-life examples.

13. The updated version of the Guide to the Mutual Agreement Procedure is expected to complement the handbook and to be of particular value to countries currently engaging in mutual agreement procedures, while at the same time acting as a self-standing document.

14. The main difference between the two products, as originally conceived, is that the handbook would be aimed at countries that did not yet have much experience with the mutual agreement procedure and other forms of dispute resolution, whereas the guide would be directed at countries that already had such experience.

15. In July 2017, the Vienna University of Economics and Business, the World Bank and the United Nations Office on Drugs and Crime (UNODC) organized a meeting on tax and good governance in Accra, with the objective of obtaining developing countries' inputs for the proposed outline of the handbook and the guide. Representatives of 17 African countries, as well as UNODC, the World Bank, the African Development Bank, the Economic Commission for Africa, the African Tax Administration Forum and the International Monetary Fund attended the meeting. The African countries attending the meeting welcomed the initiative, recognizing that they lacked experience in mutual agreement procedures. They noted that they expected that to change in the coming years, partly as a result of the base erosion and profit shifting project, but also due to the fact that the African tax administrations were building up their expertise on international tax issues. The private sector also supported the initiative, emphasizing the need to have joint training programmes between government and the business sector. Those present congratulated the work of the Subcommittee on the Mutual Agreement Procedure — Dispute Avoidance and Resolution, convened under the previous membership, for putting forward a constructive outline, while emphasizing that more emphasis was needed on how to avoid cross-border disputes.

16. The current membership of the Committee of Experts is invited to follow up on this work flow and potentially to reconvene a subcommittee on the mutual agreement procedure, so that these two products can be further discussed and finalized during the term of the current membership.

Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

17. The Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries was originally published in 1979 to strengthen the expertise of tax officials in developing countries. The main purpose of the manual was to provide practical guidance to treaty negotiators in developing countries, as treaties play a key role in international cooperation on tax matters. The manual was substantially updated in 2016 to give more practical and relevant guidance.

18. The question of a possible update of the 2016 version of the manual will be addressed at the fifteenth session of the Committee of Experts under item 5 (c) (iii) of the provisional agenda.

Conclusion

19. Over the course of the last five years, tax has climbed to the top of the international political agenda. Tax is no longer an isolated topic discussed in a closed forum. It is essential to the development and prosperity of developing and least developed countries, and for the achievement of the 2030 Agenda for Sustainable Development. The publications discussed above, albeit technical, aim to equip the tax administrations of developing countries with the necessary tools to adequately tax their citizens, negotiate tax treaties and better represent their own interests when faced with conflicts of interest from other stakeholders. Tax is at the heart of resource mobilization for development, including balancing the need for budget revenue with the need for a suitable investment climate, and these publications provide the tools for economic development and growth through the utilization of taxing instruments. Quality guidance from the Committee of Experts on important technical aspects and policy choices relating to priority areas for developing countries is a key part of ensuring good policy and administration that works on the ground in and for developing countries.

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Capacity development programme in international tax cooperation

Note by the Secretariat

1. In its resolution 2017/2, the Economic and Social Council recognized the progress made by the Financing for Development Office of the Department of Economic and Social Affairs in developing, within its mandate, a capacity development programme in international tax cooperation aimed at strengthening the capacity of the ministries of finance and the national tax authorities in developing countries to develop more effective and efficient tax systems, which support the desired levels of public and private investment, and to combat tax evasion, and requested the Office, in partnership with other stakeholders, to continue its work in this area and to further develop its activities, including relevant practical tools.

2. One of the areas of focus of the above-mentioned programme is on strengthening the capacity of developing countries to increase the potential for domestic revenue mobilization by enhancing their ability to effectively protect and broaden the tax base. The main tool developed in this area is the *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*. First published in 2015, the *Handbook* is being updated and expanded to take into account emerging issues and the latest international developments in this area.

3. The paper contained in the annex to the present note is an abridged version of chapter I of the revised edition of the *Handbook*. It provides an overview of selected issues of particular importance to developing countries in protecting and broadening their tax base.

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Annex

Protecting the tax base of developing countries*

I. Introduction

General background

1. One of the most significant policy challenges facing developing countries is establishing and maintaining a sustainable source of revenues to fund domestic expenditures. While this problem has many facets, one of the most important is protecting the domestic tax base. In recent years, increasing attention has been paid to cases in which multinational enterprises appear to have paid much lower taxes than expected in view of the applicable headline tax rates in the countries concerned. Several widely publicized cases of well-known companies paying low or no taxes have brought the questions of tax avoidance and evasion into the public political debate. In response to those cases, the Organization for Economic Cooperation and Development (OECD), at the request of the Group of 20 (G20), undertook a project aimed at analysing and addressing the techniques that corporations use to dramatically reduce their effective tax rates. This work led to the development of the Action Plan on Base Erosion and Profit Shifting. The final reports on the 15 actions listed in the Action Plan were presented to and endorsed by the G20 in October 2015.[1]

Developing country perspectives on base erosion and profit shifting

2. While substantial efforts were made to take the viewpoints of developing countries into account in the analysis and outcomes of the work carried out under the OECD/G20 project on base erosion and profit shifting, it was clear from the outset that an independent examination of the problems of tax avoidance and the resulting profit shifting and base erosion from the perspective of developing countries was required. First, most developing countries are primarily, though not exclusively, concerned with the reduction in source-based taxation, rather than the shifting of the domestic income of locally owned companies to low-tax or no-tax jurisdictions. Second, the corporate tax on inward investment typically accounts for a greater share of total revenue in countries with less developed tax systems than in those with more developed tax systems. In addition, the potential responses to base erosion and profit shifting are limited to some extent by the administrative capacity of developing countries.

3. Protecting the domestic tax base against base erosion and profit shifting is necessary if developing countries are to attain revenue sustainability. Capacity development in this area is essential to move towards that goal. The final reports of OECD have much to offer developing countries in terms of identifying issues and suggesting possible techniques to deal with the problems of base erosion and profit shifting, but it is important to keep in mind the special needs and perspectives of developing countries regarding these issues, which include the state of development of the tax system, the administrative resources available to deal with these matters, the nature of the trade and commercial relations with trading partners and regional considerations. Each country must evaluate its own situation in order to identify its particular issues and determine the most appropriate techniques to ensure a sound tax base.

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* This paper is an abridged version of chapter I of the second edition of the *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*, United Nations, New York (forthcoming), which was authored by Hugh J. Ault, Professor of Law Emeritus, Boston College Law School, and Brian J. Arnold, Senior Adviser, Canadian Tax Foundation.

[1] Available at www.oecd.org/ctp/beps-2015-final-reports.htm.

United Nations response

4. In the light of the importance of the issue of base erosion and profit shifting for developing countries and the need for further study and examination, the Committee of Experts on International Cooperation in Tax Matters established the Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries, which was mandated to inform tax officials in developing countries on these issues and facilitate the input of their views and experience into the work of the Committee of Experts and the wider work on the OECD Action Plan.

5. In addition, the Financing for Development Office of the Department of Economic and Social Affairs undertook a project to supplement and complement the work done under the OECD/G20 project and that carried out by the Committee of Experts from a capacity development perspective. The project focused on a number of issues of particular interest to developing countries and included, but was not limited to, the matters covered by OECD in the final reports. The aims of the project were twofold: to provide additional insight into the issues identified in the OECD/G20 project from the perspective of developing countries; and to consider issues involving tax base protection that are of particular importance to developing countries, but that were not addressed in the OECD/G20 project.

6. The first output of the Financing for Development Office project was the first edition of the *United Nations Handbook on Selected Issues in Protecting the Tax Base of Developing Countries*, which was published in 2015.[2] A second edition of the *Handbook* will be published at the end of 2017, updated to take account of the final results of the OECD/G20 base erosion and profit shifting project. It will also include two new chapters on base-eroding payments of rent and royalties and on controlling tax avoidance through general anti-avoidance rules. The chapters of the *Handbook* were prepared by individual authors, informed by the results of the OECD/G20 project and a review of the existing literature. Most importantly, the *Handbook* reflects the input of developing countries, obtained through the activities of the Committee of Experts and workshops held specifically to catalogue their experience and concerns with respect to base erosion and profit shifting.

7. The following four issues that are of particular concern to developing countries, which were dealt with fully in the *Handbook* but not addressed directly by the OECD/G20 project, are briefly explored in the present paper:

(a) The taxation of capital gains by source countries;

(b) The taxation of services by source countries;

(c) The taxation of rents and royalties by source countries;

(d) The use of statutory general anti-avoidance rules in domestic law.

II. Capital gains

General

8. Foreign direct investment in developing countries can be structured into locally organized subsidiaries or branches of a foreign corporation. In either case, the shares of the corporation may be held by an offshore holding company. If the operating assets in the country are sold, whether they are owned by the foreign corporation or by a local subsidiary, the country will typically have the right to tax any capital gain on the assets, under both its domestic law and any applicable tax

[2] Available at www.un.org/esa/ffd/wp-content/uploads/2015/07/handbook-tb.pdf.

treaties. Similarly, if dividends are paid by a domestic corporation, they would generally be subject to a withholding tax. However, if instead of selling the assets directly, the foreign investor sells the shares of the domestic subsidiary or branch of the foreign corporation, source-country tax may be avoided. That would also be the case if the shares of a domestic corporation held by a foreign holding company were sold. Thus, the accrued gain attributable to the underlying assets of the corporation in the source country would escape taxation by the source country on the transfer. This gain may represent appreciation in the underlying assets or retained earnings on which the shareholder would have been taxed if they had been distributed to the shareholder as a dividend. These elements of gain will escape taxation by the source country if the shares are sold unless the domestic law of the source country has special provisions covering such gains and, even if such provisions are in place, in some circumstances tax treaty provisions may prevent taxation of the gain.

Domestic law provisions

9. The structure of the capital gains provisions as they apply to the sale of shares of domestic companies differs substantially from country to country. In some countries, the provisions do not apply to any sales of domestic shares by non-residents, in others, the sale is taxed if the corporation holds certain assets (for example, real or immovable property located in the country) and, in others, a source-based claim may be asserted if the non-resident owns a specified percentage of shares in the domestic corporation regardless of the composition of its assets. In addition, some countries tax the sale of shares only when the transaction is viewed as a matter of tax avoidance: if, for example, property the sale of which would be taxable is transferred to a corporation, then followed closely in time by the sale of the shares of the corporation. There is no clear pattern in the rules of domestic law applicable in this area. The decision on how far to extend source-based taxation to the sale of shares of domestic corporations involves balancing the desire to attract foreign investment with the significance to the domestic tax base of taxing the gains.

10. A number of administrative issues must be considered if a decision is made to tax the sale by non-residents of shares in domestic corporations in certain cases. First, there are several ways to enforce the tax. The seller may be required to report the gain and pay the tax in the same way as if the gain had arisen with respect to assets located directly in the country. This approach may be difficult to enforce, especially if there is no requirement under local law for the sale of shares to be reported by the domestic corporation. Alternatively, a withholding tax obligation might be imposed on the purchaser. However, in the case of a sale between two non-residents, this obligation is difficult to enforce in practice. Additional administrative issues arise if a decision is made to tax the sale of the shares only in cases where there is a tax avoidance element.

Multiple taxation of the same economic gain

11. An additional structural issue is the impact that the sale of the shares might have on the tax status of the underlying assets of the corporation. If the sale of the shares is taxable, but no adjustment is made in the tax cost of the underlying assets, a second tax would be due on the same economic gain when the assets are sold. Whether this pattern of taxation is appropriate will depend on the general structure of corporate-shareholder taxation in the country.

Shares of a foreign corporation

12. Assuming the decision is made to tax the sale of shares of domestic corporations in certain circumstances, a separate question is how to treat the sale of

shares of a foreign corporation that has a domestic permanent establishment or owns the shares of a domestic corporation. There are significant administrative difficulties in implementing a tax on such transfers, in terms of obtaining the information needed to assess the tax and implementing effective methods for collection. Regardless of how the issue of the taxability in general of such transactions is resolved, it may be desirable to have a provision that imposes tax when the transaction can be viewed as involving tax avoidance, for example, when the transfer of the shares of the domestic corporation to a foreign corporation is followed by the immediate sale of the foreign shares or where the foreign corporation is merely a shell corporation.

Treaty aspects

13. If a decision is made to tax capital gains on the sale of shares in domestic or foreign corporations, as well as interests in partnerships and other entities, it is important to consider the extent to which that right should be preserved in tax treaties. Under many treaties, the right of the source country to tax gains on the sale of shares is limited to shares in companies the value of whose assets consists principally of real or immovable property located in the source country. Article 13 (5) of the United Nations Model Double Taxation Convention between Developed and Developing Countries provides for source State taxing rights where the ownership of shares in a domestic corporation exceeds a certain percentage of the total capital of the corporation, regardless of the nature of the underlying assets. In addition, treaty anti-abuse rules may be applicable to protect a source country's right to tax gains from the sale of shares of either domestic or foreign corporations.

III. Services

General

14. The use of payments for services to erode the tax base of developing countries is a serious issue that involves several types of services and the provisions of both domestic law and tax treaties. Domestic law provisions on income from services vary greatly among developing countries. Some countries impose tax on virtually all business services provided by non-residents in the country or to residents of the country; others impose tax only if a non-resident has a permanent establishment or fixed base in the country. Some countries impose a final withholding tax on income from services on a gross basis, while other countries tax income from services on a net basis.

15. It is relatively easy for multinational enterprises operating in a developing country through a resident subsidiary to reduce the tax payable to that country through payments for services rendered by non-resident companies from the same group. Such sums are generally deductible for the purposes of calculating the income of the company resident in the source country, but may not be taxable under the domestic law of that country once received by the non-resident service provider. Even if payments for services performed by the non-resident company are taxable under the domestic tax law of the developing country, an applicable tax treaty along the lines of the United Nations Model Convention or the OECD Model Tax Convention on Income and on Capital would in many circumstances prevent the country from taxing such payments unless the non-resident has a permanent establishment or fixed base in the country.

16. The United Nations Model Convention contains provisions on various types of services. Some types of services, for example, insurance, government services, pensions and the services of directors and top-level managerial officials, do not

provide serious scope for the erosion of the tax base of developing countries and are not dealt with in the present paper. As discussed below, the Committee of Experts has decided to include a new article dealing with income from certain "technical services" in the United Nations Model Convention.

Employment income

17. In general, under both domestic law and the provisions of the United Nations and the OECD Model Conventions, employment income derived by non-residents is taxable by a country only if the employment services are performed or exercised in the country. Under article 15 of the United Nations Model Convention, a source country is prevented from taxing a non-resident on income from employment exercised in the source country if: (a) the non-resident is employed by a non-resident employer that does not have a permanent establishment or fixed base in the source country; or (b) the employer has a permanent establishment or fixed base, the employee's remuneration is not deductible in computing the profits attributable to that permanent establishment or fixed base and the non-resident employee is not present in the source country for 183 days or more in any 12-month period. The same conditions apply under article 15 of the OECD Model Convention, except that the reference to the concept of a fixed base has been eliminated from the OECD Model Convention.

18. The broad scope of the provisions on source-country taxation of income from employment earned by non-resident employees suggests that opportunities for avoidance of source-country tax are limited. Where a non-resident employee's remuneration for employment services performed in the source country is deductible by the employer in computing income subject to tax by the source country, the non-resident employee is usually subject to tax on that remuneration by the source country. The employee's remuneration will usually be deductible if the employer is a resident or a non-resident doing business in the source country through a permanent establishment or a fixed base located in the source country. In these circumstances, the employer is usually required to withhold the tax on behalf of the employee from the remuneration.

19. Nevertheless, a developing country's tax base may be eroded if a non-resident employer avoids having a permanent establishment or fixed base in the source country or if a non-resident individual can alter his or her legal status from employment to independent contractor. A non-resident employee of a non-resident employer without a permanent establishment or fixed base in the source country is taxable only when the non-resident employee is present in the source country for more than 183 days in any 12-month period. If a non-resident is an independent contractor, under articles 7 and 14 of the United Nations Model Convention (only article 7 of the OECD Model Convention), the source country's right to tax is limited to situations where the non-resident has a permanent establishment or a fixed base in the source country and the income is attributable to the permanent establishment or fixed base, or where the non-resident stays in the source country for 183 days or more in any 12-month period. In contrast, a non-resident employee of a resident employer or a non-resident employer with a permanent establishment or fixed base in the source country is taxable on any income from employment exercised in the source country.

Entertainment and sports

20. Some entertainers and sportspersons can make large sums of money in a short period of time. Developing countries that wish to tax income derived by non-resident entertainers and sportspersons must ensure that the provisions of their domestic law and tax treaties allow them to tax such income irrespective of the legal structure of the arrangements. Under article 17 of the United Nations Model

Convention, the country in which the entertainment or sports activities take place can tax the income from those activities.

Business services

21. Under the provisions of articles 7 and 14 of the United Nations Model Convention (only article 7 of the OECD Model Convention), residents of one State are taxable by the other State on their income from services only if the residents carry on business through a permanent establishment or fixed base in the other State. Under article 5 (3) (b) of the United Nations Model Convention, a non-resident enterprise is deemed to have a permanent establishment if it provides services in the other State for 183 days or more in any 12-month period. In addition, a non-resident individual is subject to tax on income from professional or independent services under article 14 of the United Nations Model Convention if the non-resident stays in the other State for more than 183 days in any 12-month period. The rules under articles 7 and 14 do not apply to special types of income from services relating to international shipping and air transportation, entertainment and athletic activities, and employment.

22. The tax base of developing countries can be eroded through the performance of services by non-residents in two main ways. First, if a non-resident service provider does not have a permanent establishment or fixed base in the developing country, any income from services may not be taxable under the domestic law of the developing country or the provisions of an applicable tax treaty. Moreover, even if the non-resident service provider has a permanent establishment or fixed base in the developing country, that country cannot tax income from services that is not attributable to the permanent establishment or fixed base. Second, if the services are provided outside the developing country but are deductible in computing the payer's income for tax purposes in the developing country, the country may be unable to tax the income under its domestic law or the provisions of an applicable tax treaty. If the non-resident service provider has a permanent establishment or fixed base in the developing country, the income attributable to the permanent establishment or fixed base under the provisions of articles 7 and 14 of the United Nations Model Convention may include foreign source income, if, for example, the remuneration of the employees performing the services is deductible in computing the profits of the permanent establishment or fixed base. Nevertheless, unless taxes can be imposed on the foreign source income of a non-resident under domestic law, the provisions of an applicable tax treaty allowing the country to tax such income will have no effect.

23. There are several ways in which taxpayers can structure their affairs to avoid having a permanent establishment or fixed base in a country. For example, non-resident service providers might provide services at various locations in a developing country without being based in any one place for more than six months or they might use the fixed place of business of a client or a related enterprise. Although the commentary on article 5 of both the United Nations and the OECD Model Conventions indicates that a permanent establishment may exist in such situations,[3] the tax administration of the developing country may not have the necessary information-gathering resources to discover the facts required to show that there is a permanent establishment or fixed base. In other situations, a non-resident can avoid having a permanent establishment or fixed base by fragmenting its activities among related enterprises or by using related non-resident enterprises to carry out connected projects. Under article 5 (3) (b) of the United Nations Model Convention, any services performed for the same or a connected

[3] See paragraph 3 of the commentary on article 5 of the United Nations Model Convention, quoting paragraph 4 of the commentary on article 5 of the OECD Model Convention.

project are aggregated for the purposes of counting the number of days on which services are provided in the source country. There is no rule, however, to take into account services provided by related enterprises with respect to the same or connected projects. The same concern applies to construction projects under article 5 (3) (a) of the United Nations Model Convention. Specific anti-avoidance rules in domestic law or tax treaties might be useful in this regard, although the application of such rules requires effective information-gathering by the tax authorities of the developing country.

24. In the OECD final report on action 7 of the Action Plan,[4] it is suggested that the fragmentation of construction activities among related enterprises can be dealt with by the new general anti-avoidance rule to be added to the OECD Model Convention. However, the final report also provides a specific anti-avoidance rule in the commentary for those countries that prefer to deal with the problem through a specific rule. Similarly, the amendments to the United Nations Model Convention, approved in 2017, include a general anti-avoidance rule and an optional specific anti-avoidance rule in the commentary to deal with the fragmentation of construction activities. Moreover, article 5 (3) (b) was revised to delete the requirement that the activities must be "for the same or a connected project". As a result, if a non-resident performs services in a country for 183 days or more, the non-resident is deemed to have a permanent establishment in the country irrespective of whether the services are provided for the same or connected projects.

25. A multinational enterprise carrying on business in a developing country may use another company in the same group resident in a low-tax country to provide various services to the company in the developing country. These services, which often include legal, accounting, management and technical services (see the section below on technical services), may not require employees of the non-resident service provider to be present in the developing country for long periods of time. It is difficult for developing countries to counteract this type of tax planning even with effective anti-avoidance rules in place. Some countries have insisted on a period shorter than 183 days in order to minimize this limitation on their ability to tax.

Technical services

26. Some developing countries have special rules in their domestic law and tax treaties on income from technical services. Under these rules, such services are subject to a final withholding tax on a gross basis at a flat rate and the resident payer for the services is required to withhold tax from the payments to the non-resident service provider. The types of services to which the rules apply often include managerial, technical and consulting services, but these are not defined precisely.

27. Neither the United Nations Model Convention of 2011 nor the OECD Model Convention contains any specific provisions dealing with income from technical services. As noted above, in general, income from business services is covered under articles 7 and 14 of the United Nations Model Convention and is taxable only if the non-resident has a permanent establishment or a fixed base or spends a significant amount of time in the source country. The high threshold for the imposition of source-country tax on income from business services means that it is relatively easy for non-residents to provide technical services to customers in a source country without becoming subject to source-country tax. Since the payments for the services are usually deductible by the payers (either residents of the source country or non-residents with a permanent establishment or fixed base in the source

[4] OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 — 2015 Final Report* (Paris, 2015), available at www.oecd-ilibrary.org/taxation/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report_9789264241220-en.

country), fees for technical services can lead to serious base erosion in source countries.

28. The erosion of a source country's tax base by payments for technical services and the inability of the source country to tax such payments have led some countries to add specific provisions to their domestic laws and tax treaties to allow them to tax payments for technical services on a gross basis.[5] A 2011 survey by the International Bureau of Fiscal Documentation found that 134 of the 1,586 tax treaties concluded between 1997 and 2011 contained a separate article dealing with fees for technical services.[6] Under the separate articles, income from technical services is treated in the same way as royalties: source-country tax is allowed on a gross basis at a fixed rate, but is limited to fees for technical services "arising" in the source country, which usually means that the services must be performed in the source country. As noted above, these separate articles dealing with fees for technical services typically refer to managerial, technical or consultancy services, without defining those services. Under other treaties, the provisions of article 12 of the United Nations Model Convention dealing with royalties were extended to include payments for certain technical services.

29. Since 2008, the Committee of Experts has been working on the provisions of the United Nations Model Convention dealing with the taxation of income from services. In 2017, the Committee approved the addition of a new article, to be numbered 12A, to the United Nations Model Convention, which will allow source countries to tax fees for technical services on a basis similar to the taxation of royalties, that is, on a gross basis at a limited rate without any threshold requirement, even if the services are provided outside the source country. If developing countries are successful in negotiating the inclusion of this new article in their tax treaties, they will be able to protect their domestic tax base from erosion through payments to non-residents for technical services.

IV. Rents and royalties

General

30. While the OECD final reports deal with some issues involving intangibles and payments for intangibles, they address the base erosion and profit shifting problems that can arise in connection with rents and royalties only from a transfer pricing perspective. From a developing country perspective, rental and royalty payments can raise significant problems in connection with protecting the tax base. As is the case for interest and services, the payment may be deductible for the payer, thus reducing the domestic tax base, while being subject to no or limited taxation for the recipient. In addition, differing domestic law treatment of rents and royalty payments may lead to the structuring of "hybrid" transactions to take advantage of those differences.

Definitional issues

31. While domestic law definitions vary substantially, the core concept behind the notion of rent or royalty is a payment for the right to temporarily use tangible (rents) or intangible property (royalties). There are a number of difficult definitional issues arising from this basic concept. First, while payments may nominally be for

[5] See S. B. Law, "Technical Services Fees in Recent Treaties", (2010) Vol. 64, No. 5, *Bulletin for International Taxation*.

[6] See W. Wijnen, J. de Goede and A. Alessi, "The Treatment of Services in Tax Treaties" (2012), Vol. 66, No. 1, *Bulletin for International Taxation*.

the temporary use of the property, they may in fact constitute partial payments for the actual transfer of the property, as well as an implicit interest charge for the payments over time. Where the tax treatment of dispositions of property and the payment and receipt of interest differ from the treatment of royalties, taxpayers will have an incentive to structure transactions to obtain the most advantageous tax outcomes. Similarly, the return from an intangible may be embedded in the sale price of a produced good, while the taxpayer could achieve a different tax outcome by arranging for the intangible to be licensed to a related party, which manufactures the good. In addition, it may be difficult to draw the line between the use of property and the provision of technical services. Thus the design of domestic law provisions dealing with rents and royalties must take into account the possible substitution of rent or royalty payments for other payments that receive a different treatment.

Jurisdictional basis for the taxation of rents and royalties

32. Countries typically claim the right to tax rents or royalties that have a source in the jurisdiction. The source may be determined by the place of use of the property or by the tax status of the payer of the rents or royalties. Typically, if a resident taxpayer or a non-resident taxpayer with a permanent establishment in the country deducts the rent or royalty payment, the payment will be deemed to have a source in that country, thus allowing the country to recapture some of the tax revenue lost by virtue of the deduction. In this context, it is important for countries to ensure that their right to tax under international treaties is reflected in their domestic law provisions on taxing rental or royalty payments.

Structure of the tax on rents and royalties

33. Payments of rents and royalties to non-residents, which are not connected with a permanent establishment, are typically subject to a withholding tax obligation on the payer, imposed on a gross basis at a relatively low rate without any particular threshold. Under tax treaties, the rate imposed is often low or the tax is eliminated entirely. Where the royalty payment is deducted by a resident taxpayer or the permanent establishment of a non-resident taxpayer and taxed in the hands of the recipient at a low rate, there is a significant risk of base erosion. The level of royalty payments also involves transfer pricing issues.

Mixed contracts

34. Many contractual arrangements involve a combination of different elements: sales combined with the use of tangible or intangible assets, services combined with the use of equipment, and rentals of immovable property (for example, land, farms, houses or hotels) combined with rentals of movable property (for example, equipment, furniture or animals). If the different elements of a mixed contract are treated differently under domestic law and tax treaties, it will be necessary for the tax authorities to determine the amount of the payments under the contract that is attributable to each of its elements. Moreover, the parties to the contract, regardless of whether they are related, may be tempted to split the contract into several elements or to price some of the elements in order to avoid or reduce tax. Therefore, it is important for the tax authorities to identify the various elements of a mixed contract and ensure that the price for each element is correct.

Mismatch arrangements and intermediary companies

35. Often mismatches between the characterization of a transaction under the respective domestic laws of two countries are used to take advantage of the differing treatment of royalties and other payments. For example, if one country determines

ownership on a strictly legal basis and the other looks to the economic substance of the transaction, a payment of royalties may be deducted in one jurisdiction while being treated as a financing transaction involving interest payments and depreciation in the other jurisdiction. In addition, the ownership of intangibles can easily be transferred to related entities, which can create base erosion problems when intermediate companies based in low-tax jurisdictions are involved.

V. Statutory general anti-avoidance rules in domestic law

General

36. Abusive or aggressive tax avoidance arrangements erode a country's tax base and undermine public confidence in the integrity of the tax system. These arrangements pose serious problems for the income tax systems of all countries and a variety of methods are used to control them, including specific anti-avoidance rules, judicial anti-avoidance doctrines, purposive interpretation of tax legislation and robust enforcement efforts. However, these methods, even when combined, have often proved inadequate to deal effectively with abusive tax avoidance. As a result, many countries have adopted general anti-avoidance rules that potentially apply to all types of payments, receipts, taxpayers and transactions, including cross-border transactions. The purpose of a general anti-avoidance rule is to stop taxpayers from using abusive tax avoidance arrangements that reduce a country's tax base, while not discouraging legitimate commercial transactions. Thus, such rules must distinguish in some way between abusive tax avoidance transactions and legitimate commercial transactions.

37. The adoption of a general anti-avoidance rule is usually controversial. Taxpayers and their advisers typically raise several arguments against the adoption of such rules, in particular, that they are unnecessary because the tax authorities have other tools at their disposal for dealing adequately with abusive tax avoidance and that the uncertainty they cause for taxpayers discourages legitimate commercial transactions. Nevertheless, many countries have concluded that they need a general anti-avoidance rule and that the inevitable uncertainty it generates can be minimized by providing administrative guidance on its application.

The major features of a statutory general anti-avoidance rule

38. Typically, a general anti-avoidance rule applies if a transaction that results in tax benefits is carried out for the sole or principal purpose of obtaining those benefits and if such benefits are contrary to the object and purpose of the tax legislation. General anti-avoidance rules usually have the following four main features:

(a) The definition of a transaction, scheme or arrangement;

(b) The definition of a tax benefit;

(c) A purpose test that requires the principal or one of the principal purposes of a transaction or arrangement to be determined;

(d) An exception, additional condition or saving provision to ensure that the general anti-avoidance rule does not apply to transactions or arrangements that do not abuse, frustrate, defeat or contravene the underlying purpose or policy of the relevant provisions of the tax legislation.

39. Typically, countries use terms such as "transaction", "arrangement" or "scheme" as basic building blocks for identifying the target of their general anti-avoidance rules. Some countries define the relevant terms comprehensively and explicitly and other

countries leave them largely undefined, relying on the tax administration and the courts to interpret them broadly. Most importantly, the rule must apply to a series of transactions, since most aggressive tax avoidance arrangements involve multiple connected transactions. A series of transactions for this purpose should be defined broadly to include any transaction that is related or connected to, or carried out in contemplation of, another transaction or transactions.

40. A general anti-avoidance rule applies only to transactions, arrangements or schemes that would result in the avoidance or reduction of tax if the rule were not applied. For this purpose, many countries use the term "tax benefit", defined broadly to mean any avoidance, reduction or deferral of tax payable. Some countries also include in their definition of tax benefit the avoidance, reduction or deferral of amounts related to tax payable, such as interest and tax instalments. The requirement of a tax benefit is not intended to establish a high threshold or difficult condition for the application of the rule.

41. Most general anti-avoidance rules contain a purpose test: in effect, if none of the primary purposes of a transaction or arrangement is obtaining a tax benefit, the rule should not apply. However, if the primary purpose or one of the primary purposes is to obtain a tax benefit, the rule applies unless, in the case of most such rules, the transaction or arrangement is consistent with the underlying policy of the tax legislation. Most countries use a sole or main purpose test, which requires the tax authorities and the courts to weigh the purposes of a transaction in order to determine its main purpose. The onus of proof can be an important factor in this determination. Some countries put the onus on the taxpayer by explicitly providing in the general anti-avoidance rule that the purpose test is met unless the taxpayer establishes that the primary purpose of the transaction was something other than obtaining the tax benefit. A "one of the main purposes" test is used by a few countries and is reflected in the United Nations and the OECD Model Conventions. Such a test is relatively easy to satisfy. If a transaction results in a significant tax benefit, it would seem unlikely that none of the main purposes of the transaction was obtaining that benefit. Therefore, it is especially important, if a "one of the main purposes" test is included in a general anti-avoidance rule, that an exception should be included for transactions that have the reduction of tax as one of their main purposes, but which are in accordance with the object and purpose of the tax legislation.

42. Any purpose test should be based on objective facts and circumstances rather than the subjective intention of the taxpayer and this is the case with respect to the general anti-avoidance rules in most countries, which refer to the purpose of a transaction rather than the purpose of the person carrying out the transaction.

43. Most statutory general anti-avoidance rules provide an exception for transactions that are consistent with and not contrary to the object and purpose of the tax legislation and therefore do not apply to all transactions or arrangements that are carried out primarily for the purpose of obtaining a tax benefit. This exception is an important safety valve for transactions that have the primary purpose of reducing tax but are nevertheless legitimate commercial transactions. Most commercial transactions have important tax implications that taxpayers would not wish to ignore, however, many of them, and the tax benefits they produce, are consistent with the underlying purpose of the tax legislation. In the absence of an exception for transactions that reduce tax but are not contrary to the underlying purpose of the tax legislation, the tax authorities would be required to exercise their discretion, without any statutory guidance, in order to ensure that the general anti-avoidance rule is not applied to such transactions.

44. The exception for tax avoidance transactions that are not contrary to the purpose of the tax legislation can be worded in a wide variety of ways. Some countries refer explicitly to the object and purpose of the legislation; other countries refer to transactions that involve a misuse or abuse of the legislation or that are artificial in some way. For some countries, the exception is implicit in the general anti-avoidance rule as a matter of interpretation. Whichever approach is taken to provide such a safety valve, it is often difficult for the tax authorities and the courts to determine with any certainty the purpose of the relevant provisions of the tax legislation. This problem of interpretation is especially difficult when the purpose of the provisions of the tax legislation is not explicitly stated in the legislation or in any accompanying explanatory notes.

The relationship between a general anti-avoidance rule and the provisions of tax treaties

45. A fundamental principle of the law of treaties is that, in the event of a conflict between the provisions of a treaty and the provisions of domestic law, the provisions of the treaty must prevail. This principle is enshrined in article 26 of the Vienna Convention on the Law of Treaties. The application of this principle would appear to suggest that if an abusive tax avoidance arrangement results in benefits under a tax treaty, those treaty benefits must be granted even where the arrangement is subject to a country's domestic general anti-avoidance rule. Before the changes to the commentary on article 1 of the OECD Model Convention in 2003, this was arguably the result. For this reason, some countries enacted special legislation to ensure that their domestic general anti-avoidance rules apply in the event of a conflict with the provisions of a tax treaty, a so-called "treaty override", and other countries have insisted on the inclusion of specific anti-avoidance rules in their tax treaties.

46. In 2003, the commentary on article 1 of the OECD Model Convention was substantially revised to indicate that for most OECD member countries, there is no conflict between domestic anti-avoidance rules and the provisions of tax treaties. The provisions of tax treaties should therefore not be interpreted and applied to prevent the application of domestic anti-avoidance rules. Moreover, the commentary stated explicitly that tax treaties were not intended to facilitate tax avoidance and that it was not necessary for specific anti-avoidance rules to be included in tax treaties or for the application of domestic anti-avoidance rules to be protected in tax treaties. The commentary on article 1 of the United Nations Model Convention was revised in 2011 to adopt the OECD position on the relationship between domestic anti-avoidance rules and the provisions of tax treaties.

47. In the light of the 2003 revisions to the commentary on article 1 of the OECD Model Convention and the 2011 revisions to the commentary on article 1 of the United Nations Model Convention, the question is raised as to whether the revised version of the commentary should apply to a tax treaty that entered into force before the commentary was revised. Not surprisingly, taxpayers and their advisers generally take the position that only the version of the commentary applicable at the time the treaty was entered into should be relevant for purposes of interpreting the treaty. However, the OECD takes the position that the current version of the commentary applies to all tax treaties regardless of whether they were concluded before or after the commentary was revised.

48. In the amendments approved in 2017, a general anti-avoidance rule was added to both the United Nations and the OECD Model Conventions (article 29 (9)). The rule provides that treaty benefits can be denied if one of the principal purposes of a transaction is to obtain those benefits, unless granting those benefits is in accordance with the object and purpose of the treaty. In effect, the interpretive

guiding principle added to the commentary on article 1 of both the United Nations and the OECD Model Conventions, in 2011 and 2003, respectively, has been moved into the text of the Conventions. As a result, for countries that have domestic general anti-avoidance rules, the question is whether their domestic rules are consistent with the treaty rules and, if not, what are the consequences.

VI. Conclusion

49. The protection of the tax base of developing countries is an essential element in establishing domestic revenue sustainability. Identifying the features of their tax systems that facilitate base erosion and profit shifting will allow developing countries to assess the impact that such provisions have and to develop the appropriate measures to take in response. Once the problem has been identified, the next step is the implementation and administration of those solutions that are best suited to the particular circumstances of each country. Although there is no one answer to the issues of base erosion and profit shifting, a careful choice among the possible approaches can lead to substantial improvements in the revenue-raising capacity of the tax systems of developing countries.